

India Special Coverage: Pushing Back rate cut expectations

Key takeaways

- ◆ The Reserve Bank of India (RBI) kept the key policy rate unchanged at 6.5% at the 5th April monetary policy meeting. The RBI decided to continue the withdrawal of monetary accommodation to ensure that inflation continues to decline towards the 4.0% target.
- ◆ The RBI released revised growth and inflation projections as well. It maintained growth and inflation forecast of 7.0% and 4.5% respectively for FY 2025 (Apr 2024 – Mar 2025) but adjusted the quarterly projections modestly.
- ◆ Given a relatively hawkish tone of the RBI Governor who indicated that the central bank will “unwaveringly focus on price stability”, we now expect the RBI to delay the start of rate cuts to 3Q 2024 (versus our expectation of 2Q 2024 previously). However, we still expect the RBI to cut rates by 50bps in 2024. We continue to be bullish on Indian equities, Indian local currency bonds and the Indian rupee.



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What happened?

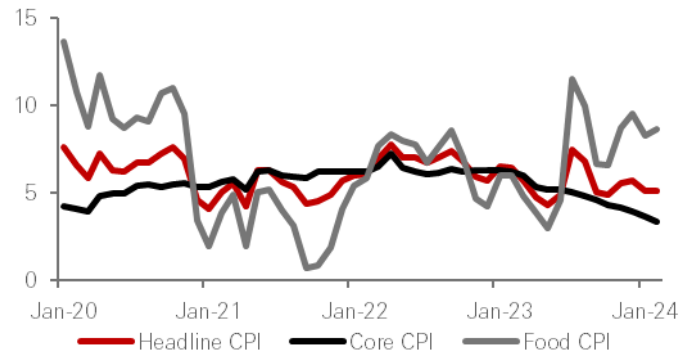
- The Reserve Bank of India (RBI) kept the key policy rate unchanged at 6.5% at the 5th April monetary policy meeting. The RBI also decided to continue the withdrawal of monetary accommodation to ensure that inflation continues to decline towards the 4.0% target. Similar to the previous meeting, the decision on interest rates was 5-1, with Prof. Varma voting for a 25bp rate cut. Notably, the decision to withdraw monetary accommodation was also passed with a 5-1 vote, unlike the unanimous decision in the previous meeting.
- RBI Governor Shashikanta Das stuck a relatively hawkish tone. He mentioned that the central bank will “unwaveringly focus on price stability” and guided that the RBI would monitor food inflation, given the warnings of coming heat wave which could potentially lead to spike in food prices. India Meteorological Department (IMD) has recently warned of longer heat waves from April to June, which poses upside food inflation risk.
- From a policymaking perspective, the RBI faces a conundrum. The core inflation has fallen rapidly from 6.8% a year ago to 3.7%, driven by imported disinflation (as China’s export prices have declined) and lower input prices owing to the decline in commodity prices. However, the headline inflation has remained stubborn, driven primarily by the food inflation. Given that food items have a significant weightage in India’s inflation basket and the fact that this is an El Nino year, the RBI is likely to vigilantly monitor any spikes in food price and lean towards delaying rate cuts.

- In its economic projections, the RBI raised its FY 2024 (Apr 2023 – Mar 2024) growth forecast to 7.6% (vs 7.3% previously) given the recent upside surprise in GDP. The RBI maintained growth and inflation forecast of 7.0% and 4.5% respectively for FY 2025 (Apr 2024 – Mar 2025) but adjusted the quarterly projections modestly. The RBI also released the FY 2026 growth and inflation projections of 7.0% and 4.1% respectively.

Investment implications

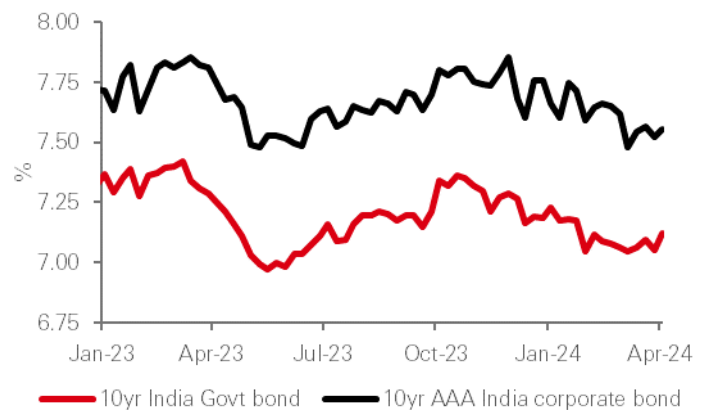
- In our assessment, the RBI is comfortable with the GDP growth, but needs to see more progress on inflation before cutting interest rates. Hence, we now expect the RBI to delay the start of rate cuts to 3Q24. We still expect the RBI to cut rates by 50bps in 2024.
- Indian government and corporate bond yields edged higher, following the RBI meeting as markets priced in a greater expectation of delay in rate cuts. However, the latest meeting doesn't change our medium-term bullish view on Indian local currency bonds.
- We continue to expect them to outperform other Emerging Market counterparts as (i) they offer attractive absolute and relative yields, (ii) eventual RBI rate cuts should translate into price gains, boosting total returns, (iii) lower-than-expected borrowing indicated in the latest budget should lead to more favourable demand-supply balance and (iv) they should benefit from steady and sizeable inflows due to recent inclusion in JP Morgan and Bloomberg bond indices.
- We maintain our overweight on Indian equities as India is one of the fastest-growing large economies, helped by tailwinds from exciting growth potential, supply chain diversification, rise in middle-class consumers and young demographics. Despite elevated valuations, Indian equities continue to be underpinned by robust earnings growth and domestic investor inflows. The recent divergence between the headline and producer price inflation should also be supportive for the corporate margins.
- Within Indian equities, we prefer large-cap stocks relative to small- and mid-cap. From a sector perspective, we favour Indian banks, consumer discretionary and industrials which will benefit from the booming digital economy, consumer spending and government spending push towards infrastructure and manufacturing.
- We expect INR to be largely stable. The RBI has recently spoken of the importance of building up a war-chest of reserves to curb rupee volatility. We expect the central bank to continue with the current stance. This could cap INR appreciation, driven by bond and FDI inflows, to modest levels.

Elevated food inflation likely leads to only modest RBI rate cuts



Source: Bloomberg, HSBC Global Private Banking as of 8 April 2024. Past performance is not a reliable indicator of future performance.

Indian government and corporate bond yields edged higher after the RBI meeting



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